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C O N F I D E N T I A L SECTION 01 OF 04 SHANGHAI 000769

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SUBJECT: SHANGHAI ACADEMICS, BUSINESSMEN TO AMBASSADOR HOLMER: KEEP  
SED STRATEGIC

REF: A. SHANGHAI 452

[1](#)B. SHANGHAI 337

[1](#)C. BEIJING 7133

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CLASSIFIED BY: Christopher Beede, Political/Economic Chief, U.S.  
Consulate Shanghai, Department of State.

REASON: 1.4 (b), (d)

(U) Classified by Political/Economic Section Christopher Beede  
for reasons 1.4 (b) and (d).

[1](#)1. (C) Summary: Shanghai-based academics and businessmen stressed the importance of having the Strategic Economic Dialogue (SED) focus on long-term policy issues between the two countries in order to insure its relevance and sustainability beyond 2009 in meetings with Treasury Department SED Special Envoy Ambassador Holmer. During his mid-November visit to Shanghai, academics also noted that anti-globalization and nationalistic forces in both countries threatened increased United States-China interdependence. China's economy is "a little overheated," but not dangerously so given the size of China's economy and the capabilities of its policy-makers. China's economy is increasingly in the private sector's hands. This trend is being resisted by the "old-line" ministries and encouraged by the newer regulatory commissions. As a result of this trend, there are now a plurality of voices and interests deciding China's economic future. Foreign capital is finding it increasingly difficult, if not impossible, to enter China and mergers and acquisitions deals are being blocked by the Ministry of Commerce as China attempts to cope with its over-liquidity problems. End summary.

[1](#)2. (SBU) Strategic Economic Dialogue Special Envoy Ambassador Alan Holmer discussed how to advance USG economic policy goals in China with Shanghai-based academics and two groups of

international businessmen during his November 15-16 visit to Shanghai. Additionally, Ambassador Holmer met with Citigroup China CEO Richard Stanley, gave a speech on SED goals at an American Chamber of Commerce event, and was interviewed by the China Business Television Network. The Treasury Department's delegation also included SED Senior Policy Advisor Daniel Wright, Chris Winship and Embassy Beijing Finatt.

13. (SBU) On November 15, Ambassador Holmer joined the Consul General at a dinner hosted by Shanghai Institute for International Studies (SIIS) President Yang Jiemian. The sustainability of the SED beyond the current U.S. administration, overcoming resistance from anti-globalization, anti-competition, and nationalistic groups, and maintaining the strategic nature of the SED were concerns put forth by Chinese participants.

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Maintaining the SED's Importance, Making It Sustainable  
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14. (C) SIIS Vice President Chen Dongxiao noted that the SED has provided China and the United States with a valuable mechanism for policy dialogue that has helped establish new habits of cooperation between the two countries. Both the Chinese Government and academics hope that the SED is sustainable beyond Secretary Paulson's tenure at the Treasury Department. Chen

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also expressed concerns that the SED would be "downgraded" from the strategic level and become "too occupied with post-WTO trade issues and JCCT-like" deliverables. Despite this, Chen said that the Chinese Government has agreed to strike a balance between strategic and long-term issues and short-term agreements.

15. (C) Ambassador Holmer said that the reason the SED is being held immediately after the JCCT is to allow the more transactional issues to be decided in the JCCT context. However, he noted, it appeared that the Chinese side is not interested in addressing deliverables in either the JCCT or the SED context. "While forming a long-term vision, we do need to have sufficient benchmarks to make sure that the mechanism

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works." Deliverables "show progress towards an ultimate vision; they are signposts along the road that demonstrate where we are going," he said.

16. (C) Shanghai Academy of Social Sciences (SASS) Vice President Huang Renwei said that Beijing supported the SED process, but wondered whether or not it is as welcome in Washington. He expressed concern about Congress's perception of the SED. Ambassador Holmer responded that this further underscored the necessity of the SED providing concrete examples of successful cooperation. This would show the American people the benefits of engagement with China.

17. (C) SASS's Huang said that the SED should be forward-looking, focusing on issues that are three to five years ahead, or on immediate critical issues such as global economic crises that threaten both China and the United States. If the SED became a mechanism to coordinate policy between the two countries, then it would be sustainable into the future. However, focusing only on short-term items would weaken the value of the SED as a policy-making mechanism, he said.

18. (C) SIIS's Yang, noting that he had passed on a message from Daniel Wright to Beijing officials (ref a), said that Beijing had assured him that officials there want to make the SED into an ongoing and sustainable policy dialogue mechanism. The message from Beijing was: "The ball is on the U.S. side." Yang said that unless the December 2007 SED is successful, he doubted whether there would be a December 2008 SED.

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Pre-Globalization Forces Threaten Deepening Interdependence  
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¶9. (C) SIIS's Chen observed that "pre-globalization" forces in both China and the United States threaten to undermine the deepening economic interdependence between the two sides. The Chinese are interested in how the United States will deal with these anti-globalization forces that will be looking for scapegoats should the U.S. economy weaken. Both Chinese academics and government officials will be closely watching the rhetoric coming from the Presidential primary races of both parties.

¶10. (C) SASS Institute of World Economy Deputy Director Xu Mingqi said that both the United States and China have influential interest groups that have a nationalistic and protectionist outlook. In China, these groups are led by big and influential companies that are facing unwanted competition from abroad. The Chinese Government attempts to placate these groups by using economic policy to address their economic interests. However, as an economist, Xu knows that the economic results of protectionism are "bad" and he stressed that Chinese officials need to study economics.

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Benefits of Globalization Spread Widely, Pain Felt Narrowly

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¶11. (C) SIIS Institute of World Economy Research Assistant Zha Xiaogang asserted that protectionist sentiment is stronger in the United States -- especially during a presidential campaign -- than in China. The benefits of globalization, in the form of cheaper trade goods, are spread widely and broadly across society. The downside of globalization, however, in the form of lost jobs is focused narrowly. The United States Government needs to address those who are losing out to trade.

¶12. (C) Protectionism is different than nationalism, said Zha. China tends to more nationalism than the United States. Though China is working very hard to legalize many economic rules and practices, China still needs to avoid the extremes of blaming every setback on economic nationalism.

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Can U.S. Make Promises Beyond 2009?

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¶13. (SBU) At a lunch hosted by the Consul General on November 16, Ambassador Holmer met with Chinavest President Robert Theleen, Standard Chartered Senior Economist Stephen Green, Shanghai Municipal Financial Services Office (SHFSO) Director Fang Xinghai, eTang CEO Tang Haisong, Shenyin and Wanguo Securities Company Chairman Ding Guorong and Pudong Government Research Vice Director Zhang Yong.

¶14. (C) SHFSO's Fang said that the Chinese leadership is keenly aware of the United States political calendar and its affects on commitments that Secretary Paulson and others are able to make during the upcoming SED meetings in December. Chinese negotiators "will know that the other side does not have the ability to make commitments beyond 2009." There is no mystery, on the other hand, who will be in charge in China, Fang added. The Chinese leadership is "always able to make decisions in the interests of the country as a whole and is not dependent on special interests."

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Old China vs. Regulatory China

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¶15. (C) Chinavest's Theleen has observed a "tectonic shift" in Chinese Government in the past decade, accelerated since China's 2001 entry into the World Trade Organization. Economically and politically, there is no longer a single voice in Beijing that is making policy. The Chinese Government is "getting smarter."

But, the Chinese Government has split into two camps: "Regulatory China" and "Old China." The traditional ministries represent interests and micro-management governing techniques of Old China, while the historically younger Commissions represent the future of Regulatory China. The technocrats who make up Regulatory China are more modern and rule-of-law oriented than those in the Old China camp.

¶16. (C) The conflict between the two camps is most obvious in the fault line that has developed around the question of "Who owns the Chinese economy?" In the post-WTO era, that question is largely being answered by taking the economy out of the hands of the government and through privatization, putting the economy into the hands of the Chinese people. Theleen added that when he meets privately with Chinese officials representing Regulatory China, he is told that Secretary Paulson and the SED process are not pushing hard enough to advance the reforms that these officials believe China needs.

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China is a Little Overheated, But No Worries  
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¶17. (C) SHFSO's Fang said that the United States should not be concerned about a little overheating in China since China, as a continental economy, is more than capable of absorbing the heat currently being produced. While there is inflation in food and consumer prices, "we are not so overheated that we are in danger of collapse," he said. Standard Chartered's Green agreed, but said that there is always the danger that the Chinese Government might overreact given the already distorted system caused by its restrictive capital controls and over-liquidity problems.

¶18. (C) Fang responded to Green's concerns, noting that when the market is "imperfect as China's is" there is always room for government policies to adjust the economy. "It is too early to prejudge the government's actions on the economy. They have been managing the economy for the last twenty years. They have a lot more information about what is actually happening in the economy and they know what they are doing," he said.

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Mergers and Acquisitions: Difficult -- If Not Impossible  
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¶19. (C) Several interlocutors discussed the problem that foreign

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companies are having getting approval by the Chinese Government for large-sized mergers and acquisitions. Since the new M&A rule was released in September 2006 (Ref B), no deal has made it through the new process, noted Chinavest's Theleen. In fact, Theleen knew of more than 35 large industrial projects, involving significant amounts of technology transfer along with the investment that are pending at the Ministry of Commerce (MOFCOM) and there is starting to be a "panic" about the inability of capital to flow through legitimate channels into China. Theleen noted the danger that this problem had to enter the U.S. political process as large multi-national companies began complaining about the barriers China is raising to their investments.

¶20. (C) eTang's Tang said that friends at MOFCOM told him that the China Securities Regulatory Commission had focused attention on China's stock market bubble and that the government is taking the steps it needed to increase the supply of good companies listing on Chinese bourses, rather than allowing them to list overseas. The newly-released catalogue of investment (Ref C) demonstrated that while China is interested in guarding its economic and national security, it is still open for business -- especially in the areas of life sciences and the environment.

¶21. (U) Ambassador Holmer's delegation did not have opportunity to clear this report.  
JARRETT